

5 State Compensation
368.41 Mutual Insurance
#20r Fund (Mont.)
1992- Annual report

MONTANA STATE FUND

ANNUAL

REPORT

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**State Compensation Mutual
Insurance Fund**



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PROUDLY SERVING MONTANA

The State Fund is a nonprofit, independent public corporation established for the purpose of allowing an option for employers to insure their liability for workers' compensation and occupational disease coverage. It is Montana's largest writer of workers' compensation insurance. Working for the people of Montana, the 220 State Fund employees provide services following high standards of quality and accuracy.

To meet these standards, State Fund has set objectives to help its employees better serve its clients. The Underwriting employees take great care to offer same-day response on all telephone inquiries and rapid and accurate cancellation of coverage for noncompliance with reporting and/or premium requirements. Not only do they assure proper premium collections through timely and appropriate audits of policyholders' records, but they also provide complete and accurate actuarial information.

To help prevent injuries in the workplace, Safety personnel

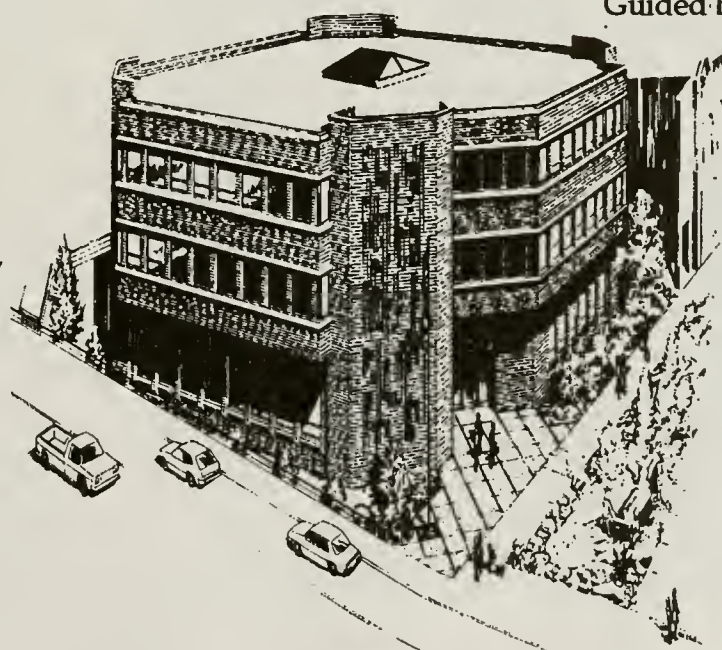
assist policyholders in implementing safety programs which are customized for their particular businesses.

A major objective of the Benefits Department is to ensure payment of wage-loss benefits within five days of receipt of required supportive documentation. In addition, they set accurate claims reserves to meet future obligations of the Fund and provide information for claims management through on-site field contacts. Rehabilitation Services works very closely with the injured workers to return them to work as soon as possible after an injury occurs.

Working behind the scenes and often not recognized because of their lack of public

involvement are other support service units. The Administration and Finance Department provides financial management, accounts payable, accounts receivable, prompt receipt of premiums to maximize investment income, and general services to the State Fund. Providing data processing, office automation, and technical support services are the employees of the Management Information Services Department. The Legal Department specializes in the field of workers' compensation law. This department works closely with Claims and Underwriting to help resolve legal problems. The staff represents the State Fund and policyholder when litigation becomes necessary.

Guided by the Executive Department and a five-member Board of Directors, the employees at State Fund set their goals and objectives with one end result in mind: to continually improve the services provided to our clients, the people of Montana.



LETTER TO OUR POLICYHOLDERS

The State Compensation Mutual Insurance Fund (State Fund) continued to fulfill its mission to Montana's employers and injured workers during Fiscal Year 1992. The State Fund continued to provide the maximum level of service at the lowest possible premium. In 1992, more Montana employers chose the State Fund as their insurance provider, up 275 policyholders from the previous year for a total of 26,682.

EXPLANATION OF ACTUARY'S REPORT

The review by the Actuary, showing a deficit, was not

State Fund will pay the proper benefits to injured workers while providing an alternative coverage to employers at the lowest possible cost.

unexpected. In 1990, the State Fund was initially undercapitalized. Similar-sized insurance companies writing workers' compensation insurance would require \$40 to \$60 million in surplus at the start of business. The State Fund started with \$12 million. An adequate surplus would have prevented a deficit in the Fund.

This was not the only reason for the deficit. Since the Montana legislature passed major reform legislation in 1987 and 1991, the loss experience has not yet reflected the anticipated positive impact of this legislation. Because the results of the statutory changes are not yet reflected in the Montana data, the Actuary must use past Montana history and national trends to estimate future liabilities. The State Fund management believes the financial position of the State Fund will improve in the future when more recent statistics are used

in estimating future costs. It also believes State Fund coverage is still a viable and necessary option to Montana employers and employees (currently 75% of the workers' compensation market in Montana). Public policy dictates and reasonable economic concerns demand this option continue to be made available.

THE MISSION

As in the past, after an injury, the State Fund will pay the wage-loss and other benefits, as required by law, to injured workers while providing an alternative coverage to employers at the lowest possible cost. The State Fund also will continue to pursue an aggressive program to return a worker to work as soon as possible after injury. The mission guides our employees to work cooperatively to achieve the high standards and excellent quality of service.

THE FUTURE

What's ahead in the future?

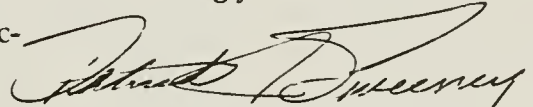
The State Fund fully recognizes the need to contain costs but also recognizes a well-run business is a cost-effective business. Therefore, major reform within the company will include a strengthening of staff in critically understaffed areas, as well as in areas of growth and change. Ongoing training programs for new and existing employees will target changes in benefit structures. Operations will be streamlined through automation and re-engineering of work processes. This effort to streamline the process includes complete automation of the management of claims files for streamlining the indemnity benefits process and for improving the reserving process. These future changes will further enable State Fund to achieve its mission—to continue to provide quality insurance coverage at

the lowest possible cost to all employers and employees across Montana.

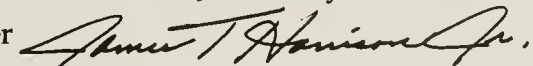
Management also believes additional legislative changes are needed in several areas such as medical cost containment, safety, and fraud. Accordingly, we will assist in proposing comprehensive measures in these and other areas, and we hope the propos-

als will receive a favorable response from the legislature.

We wish to thank the policyholders and their employees for their continued support and commitment. We look forward to serving you in the future.



Patrick J. Sweeney, President



James T. Harrison, Chairman



Board of Directors

Front Row: Les Hirsch and Robert Short; Back Row: James T. Harrison (Chairman), Robbie Holman, Clyde Smith, and Patrick J. Sweeney (President)

FY 1992 ACCOMPLISHMENTS

During FY 1992, the State Fund continued to fulfill its mission, while achieving the following significant accomplishments:

- ♦ *Established an on-line reserving system which allows for more rapid and more accurate reserving updates;*
- ♦ *Changed the premium collection process providing for calculation of premium by the insured, allowing for earlier collection of premium;*
- ♦ *Implemented a claims file tracking system that uses bar coding, allowing for improved file search and retrieval;*
- ♦ *Established an automated system for reporting to the National Council on Compensation Insurance which netted about \$140,000 one-time reduction in assessment for services;*
- ♦ *Expanded safety staff for improved safety consultations for policyholders; and*
- ♦ *Initiated changes to the premium collection process that allow for modifying premium for such programs as credits for hourly wages to construction firms, and for optional programs such as medical deductible.*

1993 AND BEYOND

To better serve its employers and, ultimately, the state of Montana, State Fund proposes major changes in claims management within the next few years. These changes will drastically change claims management as we know it today. Not only will these changes make us more competitive in an increasingly technological society, but will also prepare us to serve our clients more efficiently and accurately. The proposed changes are as follows:

- ♦ *Establishing a reasonable examiner-to-claim ratio;*
- ♦ *Improving the rehabilitation coordinator-to-claim ratio;*
- ♦ *Strengthening of the loss control program;*
- ♦ *Pursuing both claims and policy fraud which burden the system;*
- ♦ *Increasing the revenues through premium auditing and premium collection;*
- ♦ *Streamlining processes in three areas: claims management, data processing, and files management;*
- ♦ *Redesigning the indemnity and reserving computer systems;*
- ♦ *Automating claims management, which is currently performed on a paper-based system; and*
- ♦ *Introducing an imaging system, which will eliminate the need for paper files and increase productivity and efficiency.*

WORKING TOGETHER AS A TEAM TO SERVE OUR CLIENTS

State Fund will insure any employer in Montana requesting coverage, and it will not refuse coverage for an employer.

In 1992, all State Fund employees worked together to offer an alternative workers' compensation insurance program to Montana employers at the lowest cost possible and to pay the statutory benefits to their injured workers. They continued to improve services in the areas of safety, alternative products, claims management, and medical cost containment. Additionally, as in the past, the employees worked closely with employers, legislators, and the public to return injured workers to employment, to implement and encourage safety programs, and to improve cost containment practices. Each area contributed its expertise and dedication to provide the best possible service to State Fund customers.

Underwriting Department

The Underwriting Department continues to strive to offer excellent service to our policyholders. As of June 30, 1992, the State Fund insured 26,682 Montana employers. The Policy Services Division implemented a medical deductible program and a construction industry premium credit program. Both programs, mandated by the Montana legislature, offer greater flexibility in the service we can offer our customers.

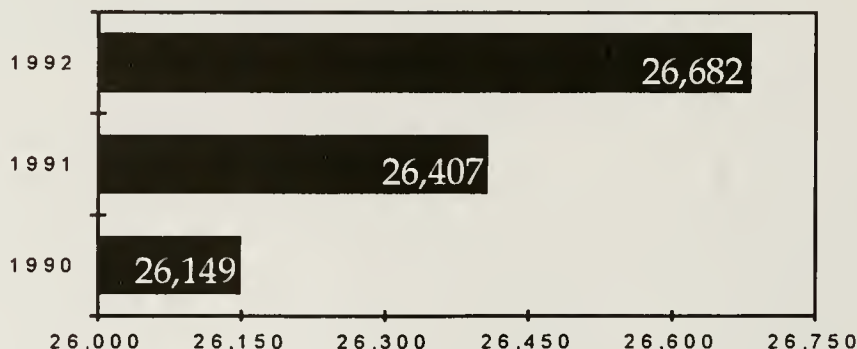
The medical deductible program offers a modest premium discount in exchange for the policyholder accepting a deductible for each and every claim which occurs during the specified policy year. Policyholders must elect to participate in this program annually.

Participation in this program has been small, with less than a dozen policyholders electing to participate.

The construction industry premium credit program offers a premium discount to qualifying employers based on the employer's rate of pay. This program involves an annual survey and application process for construction employers. Approximately 650 construction employers qualified to participate in the program for fiscal year 1993.

Both the medical deductible program and the construction industry premium credit program required extensive changes to our computer programs, as well as considerable efforts in development and implementation of the programs.

Number of Policyholders



Safety

The State Fund continues to provide policyholders with quality consultative and professional assistance when developing and implementing loss prevention and safety programs. We are firmly committed to loss prevention as a cornerstone in reducing and containing workers' compensation costs. Our seven field consultants conducted 2,389 on-site consultations in FY92. In addition, they conducted safety training sessions, which reached over 960 individual employees.

Our Safety Incentive Program remained a service priority. In FY92, nearly \$200,000 in premium rebates were returned to eligible and certified policyholders. A study of the 45 firms who have already completed the two-year program reveals that 87% experienced an average loss ratio decrease of 50% or greater.

Auditing

Fiscal year 1992's accomplishments included 1,348 completed audits, which generated \$744,582 of additional premium for the State Fund. In addition, we verified the collection of over \$10 million in earned premium.

Claimants should be able to speedily obtain benefits, and employers should be able to provide coverage at reasonably constant rates.

Prior to State Fund's administration of the audit function, historical data indicates approximately 2% to 3% of State Fund's policyholders were subject to audit within a given fiscal year. Under State Fund's first completed fiscal year, approximately 5% of policyholders underwent an audit during FY92. The increase in audited policyholders can be attributed in a great part to the implementation of the desk audit program which concentrates on smaller policyholders who, prior to State Fund's administration, were effectively exempt from audit. Over the period, approximately 45% of the audits conducted

resulted in premium due, 14% of the audits resulted in a refund of premium paid, and the remaining 41% of the audits conducted resulted in no premium change to the policyholder.

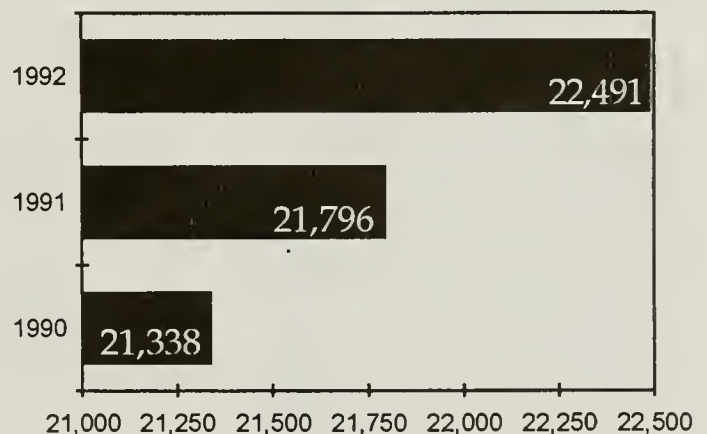
Benefits Department

Claims

In Fiscal Year 1992 there were 22,491 job-related accidents reported, an increase of 695 when compared to 21,796 in FY91. There were 4,444 loss-time claims, an increase of 645.

With the implementation of new case management policies and procedures and because the claims examiners performed exceptionally well in the areas of claim reserving and claims closure, outstand-

Number of Accidents



Number of Open Claims (Jan 92 - June 92)

ing results were realized during the third and fourth quarters in 1992. In six months, there was a reduction of 1,689 claims. (See chart.)

	JAN 92	JUNE 92	DIFFERENCE
OLD FUND (Prior to July 90)	8,168	6,364	-1,804
NEW FUND (After July 90)	4,841	4,956	+115
TOTAL	13,009	11,320	-1,689

Medical Cost Containment

The ever-escalating costs of medical benefits are a major concern of the State Fund. Each year the cost of medical services constitutes a significant percentage of total benefit dollars.

The State Fund over the past several years has implemented cost saving programs:

State Fund employees work cooperatively to achieve the high standards and excellent quality of service it has promised.

- ♦ *Utilization of an automated computer system which analyzes each medical bill, reduces it to the amount allowed under the medical fee schedule, eliminates duplicate payments, and generates the necessary data to pay the bill.*

- ♦ *Before bills are paid, claims examiners review each bill to verify the treatment is related to the workers' compensation injury, the medical provider is an authorized provider, and the treatment is reasonable and necessary.*

- ♦ *Preferred provider programs have been established for TENS (Transcutaneous Electrical Nerve Stimulator) units and supplies.*

- ♦ *An ongoing program to develop a network of providers for durable medical goods and equip-*

ment was established.

- ♦ *Private physical rehabilitation nurses were assigned to serious injuries or problem claims to provide for appropriate and quality treatment.*

- ♦ *Expert medical consultants are available to the claims examiners to assist in the management of medical treatment and to provide expert opinions on various issues.*

Most recently, the State Fund has been very active in some important areas: representation on the Department of Labor and Industry's advisory committee on medical fees, utilization issues, and hospital rates; and recommendations to the Governor's Task Force on Workers' Compensation and the Select Legislative Interim Committee on Workers' Compensation, particularly emphasizing legislative adoption of a managed care system for the treatment of injured workers.

Vocational Rehabilitation

The State Fund has continued to aggressively control the costs of rehabilitation, while at the same time has taken a proactive approach in providing effective rehabilitation services to the injured worker.

To bring about effective rehabilitation and cost containment, the State Fund stresses early return-to-work in a part-time or modified position with the time-of-injury employer. In those claims where the injured worker cannot return to the time-of-injury position, efforts are directed at returning the worker to a permanent modified position with the same employer. The State Fund also stresses an early referral policy for rehabilitation services.

These measures have brought about effective cost containment and appropriate rehabilitation services for the injured worker. The average cost per closed claim in FY92 was \$1,021. (See graph below.) During the same period of time, the number of rehabilitation referrals have increased from 1,663 to 2,028.

Claim closures increased from 1,651 in FY91 to 2,333 in FY92. In FY92, 325 closed cases were released to the time-of-injury job; 82 were released to permanent modified work with the time-of-injury employer; 681 of all the cases closed resulted in release to work in some other capacity. Resolution of the remaining rehabilitation claims were delayed or suspended because of litigation, continuing medical complications or

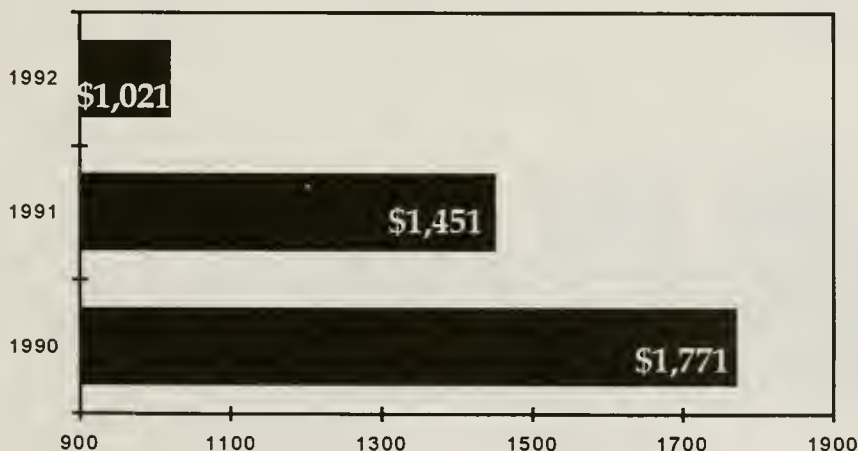
State Fund maintains that the workers' compensation system will return a worker to work as soon as possible after the worker has suffered a work-related injury or disease.

negotiated settlement of benefits.

Fraud

Over the last several years, the State Fund has intensified its efforts to combat fraud by training claims examiners in fraud detection, investigating potential problems, training and using private investigators, and funding a full-time position in the Criminal Investigation Bureau of the Montana Attorney General's Office. The Benefits Department follows up on every report provided by the Department of Labor and Industry Fraud Hot Line and every questionable circumstance recognized or reported to claims examiners. If evidence warrants, cases are referred to the Attorney General's Office for additional investigation and to the County Attorneys for prosecution.

Average Rehabilitation Cost Per Closed Claim



INDUSTRY COMPARISON

Plan I - Self-Insurance

	<u>1989-90</u>	<u>1990-91</u>	<u>1991-92</u>
Number of employers enrolled	45	46	55
Gross annual payroll*	\$665,071,607	\$977,590,700	\$1,032,169,827
Total reported accidents**	4,962	5,237	5,617
Compensation benefits paid	\$11,701,869	\$11,698,407	\$11,699,149
Medical & burial benefits paid	\$5,205,136	\$5,525,248	\$5,525,436

Plan II - Private Carrier

	<u>1989-90</u>	<u>1990-91</u>	<u>1991-92</u>
Number of employers enrolled	4,584	4,397	4,249
Annual premium*	\$50,995,172	\$42,915,946	\$39,926,497
Total reported accidents**	6,384	5,129	4,817
Compensation benefits paid	\$22,378,385	\$23,588,298	\$23,489,625
Medical & burial benefits paid	\$9,504,860	\$10,405,702	\$10,405,200

Plan III - State Fund

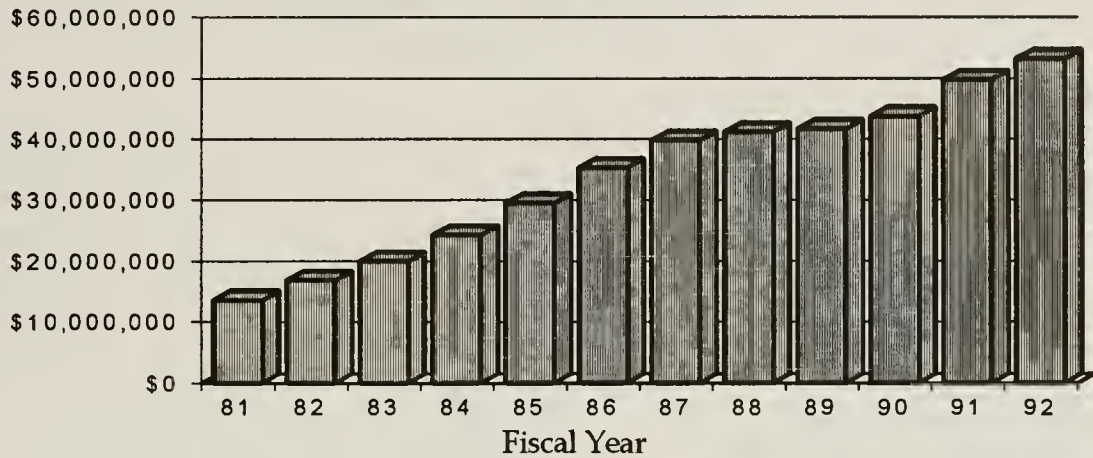
	<u>1989-90</u>	<u>1990-91</u>	<u>1991-92</u>
Number of employers enrolled	26,149	26,407	26,682
Annual premium	\$93,795,170	\$102,448,520	\$126,764,562
Total reported accidents**	21,338	21,796	22,491
Compensation benefits paid***	\$61,810,348		
New Fund Injuries		\$6,613,464	\$25,062,311
Old Fund Injuries		\$74,849,444	\$52,409,523
Medical & burial benefits paid***	\$31,671,521		
New Fund Injuries		\$10,057,370	\$22,778,548
Old Fund Injuries		\$23,702,935	\$14,213,199

* Figures shown on calendar year basis.

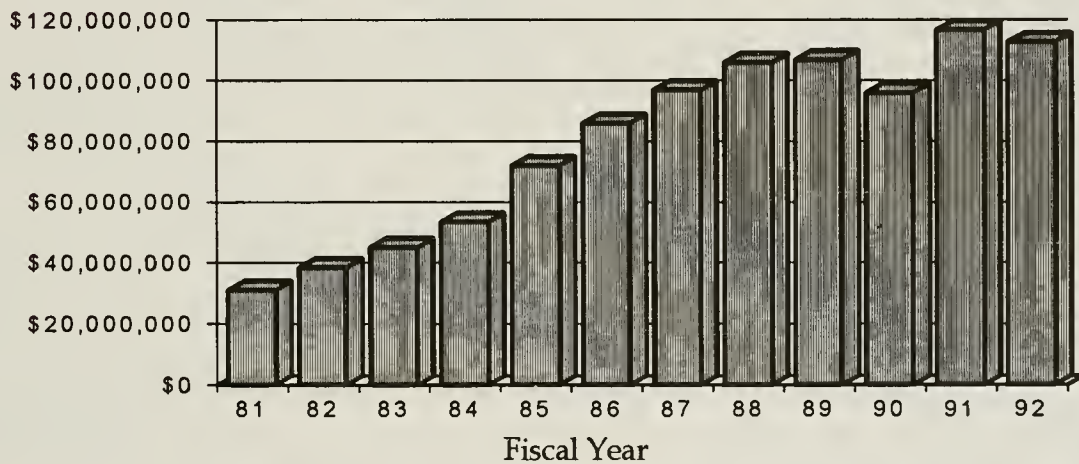
** Represents total reported accidents during the fiscal year, without regard to date of injury.

*** By law, the State Fund now separates injuries between "old" fund and "new" fund injuries based upon the accident date. "New" fund applies to injuries on or after July 1, 1990. "Old" fund applies to all injuries prior to July 1, 1990. The State Fund must keep the "new" fund actuarially sound.

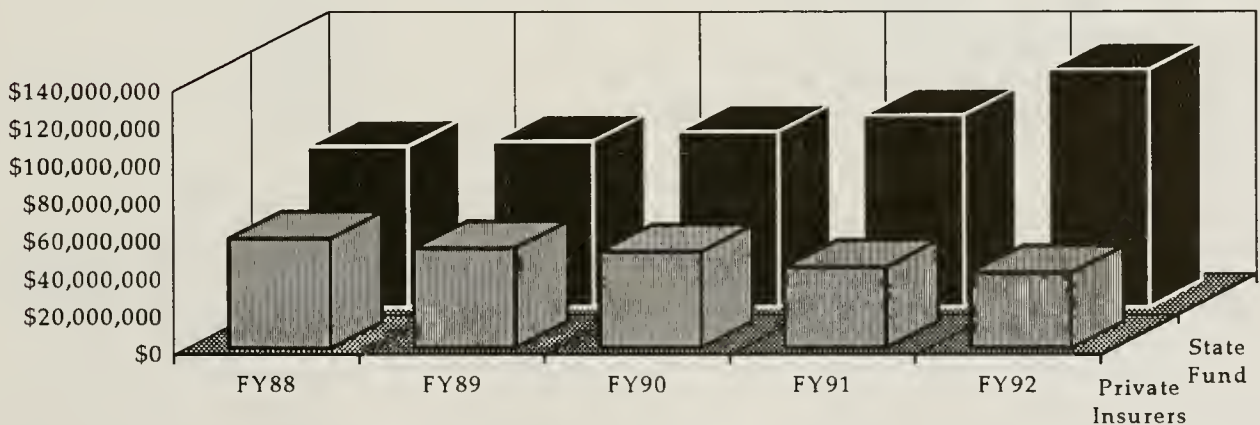
Total Medical – All Plans



Total Compensation – All Plans



Annual Premium



BALANCE SHEET

Year ending June 30, 1992

ASSETS

Cash in Treasury		3,108,234
Premium Receivable		31,555,220
Interest Receivable		848,527
Short-term Notes & Loans Receivable		256,063
Adjusted Accounts Receivable		3,547,021
Property Held in Trust		10,502,632
Investments:		
Federal Securities	28,444,188	
Corporate Securities	22,748,207	
Short-term Investment Pool	82,012,000	
Long-term Securities on Loan	<u>6,741,071</u>	139,945,466
Plus: Security Premium	558,527	
Less: Security Discount	<u>(76,822)</u>	<u>481,705</u>
Net Investments		140,427,171
Supplies Inventory		58,913
Expense Advances to Employees		9,368
Equipment	1,237,267	
Less Accumulated Depreciation	<u>(325,696)</u>	
Net Equipment		911,571
Intangible Assets		36,738
Prepaid Expense		<u>1,830</u>
TOTAL ASSETS		<u><u>\$191,263,288</u></u>

LIABILITIES AND FUND EQUITY

Liabilities

Adjusted Accounts Payable	2,467,413	
Advance Deposits	18,710,399	
Compensated Absences	433,424	
Actuarially Estimated Claims Liability	211,994,569	233,605,805

Fund Equity

Contributed Capital	12,011,302	
Unrestricted	<u>(54,353,819)</u>	<u>(42,342,517)</u>
TOTAL LIABILITIES AND FUND EQUITY		<u><u>\$191,263,288</u></u>

STATEMENT OF OPERATIONS AND CHANGES IN FUND EQUITY

Year ending June 30, 1992

INCOME

Gross Earned Premium	\$127,235,245
Less: Reinsurance Premium Paid	(269,614)
Safety Incentive Refunds	<u>(201,069)</u>
Net Earned Premium	\$126,764,562
Interest Earnings on Investments	6,348,427
Interest Earnings on Loan to Old Fund	272,363
Other Income	<u>68,185</u>
TOTAL INCOME	\$133,453,537

EXPENSES

Claims Expenses:	
Compensation Benefits	\$25,062,311
Medical Benefits	22,778,548
Increase in Actuarially Estimated Claims	<u>120,769,569</u>
Total Claims Expenses	<u>\$168,610,428</u>
Other Expenses:	
Operating Budget	\$5,948,386
Assessments	1,986,056
Other Expenses	<u>1,278,842</u>
Total Other Expenses	<u>\$9,213,284</u>
TOTAL EXPENSES	<u>177,823,712</u>
RESULTS OF OPERATIONS	(\$44,370,175)
June 30, 1991 Fund Equity	2,035,795
Decrease in Contributed Capital	<u>(8,137)</u>
FUND EQUITY - JUNE 30, 1992	<u>(\$42,342,517)</u>

ACTUARIAL LETTER

One Tabor Center
1200 Seventeenth Street, Suite 1200
Denver, CO 80202-5812
303 628-4000
Fax: 303 628-4090

Tillinghast

A Towers Perrin Company

December 1, 1992

To Members of the State Fund Board of Directors:

Tillinghast, a Towers Perrin company, was engaged by the Montana State Compensation Mutual Insurance Fund (the Fund) to estimate the unpaid loss and loss adjustment expenses as of 6/30/92 for the Fund's workers' compensation exposure. We examined both the New Fund and the Old Fund, using data as of 9/1/92. As of 6/30/92, our estimated discounted liability is \$212.0 million (based on a 7% interest rate). Thus the discounted liabilities exceed the assets by \$42.3 million. Our analysis and results, along with the discussions of important reliances and limitations, are documented in rate and other reports to Fund management. Note that this estimate assumes that sufficient assets are held to generate the appropriate investment income.

Due to the high degree of uncertainty involved in projecting the Fund's workers' compensation losses, a target surplus value of zero is virtually certain to result in a deficit for some years. On a long-term basis, one could state that there would be a 50% probability of posting a deficit for any given year and a 50% probability of posting a gain.

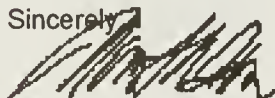
Therefore, we recommend the Fund set a long-term goal of achieving and maintaining surplus based partly on industry standards. This means rate changes should not only reflect cost estimates for the prospective year, but also include a provision for building surplus. Obviously, the larger this rate increase associated with surplus buildup, the more quickly the fund will achieve a goal of eliminating a deficit position and having a positive surplus.

A key phrase in the forgoing recommendation is "long-term". Efforts to build surplus should be viewed as multi-year; likewise, erasing an existing deficit can be accomplished over several years. While this long-term approach will likely leave the Fund in a deficit position at the close of next year (1993), we believe that the long-term approach is preferable to the volatility of massive year-to-year rate changes and dividends. This recommendation rests on two important assumptions. First, we have assumed that the Fund will have sufficient cash flow to fund claims obligations. Second, we have assumed that the Fund will be an ongoing concern until the claims obligations are fulfilled.

It is our opinion that aggressive rate level action to completely erase the estimated deficit on January 1, 1993 is not the best way to attain the goal of the Fund being self-supporting and not having unnecessary surplus. Instead, the Fund should have a long-term goal of building the necessary surplus, with perhaps the first step of this goal being a modest rate change on January 1. This rate change recommendation assumes that, after implementing the 7/1/92 rate change, the current year is adequately priced.

By following a plan to eliminate the deficit and build reasonable surplus, and by adjusting rates to reflect emerging loss experience, the Fund can expect to steadily move toward being adequately funded.

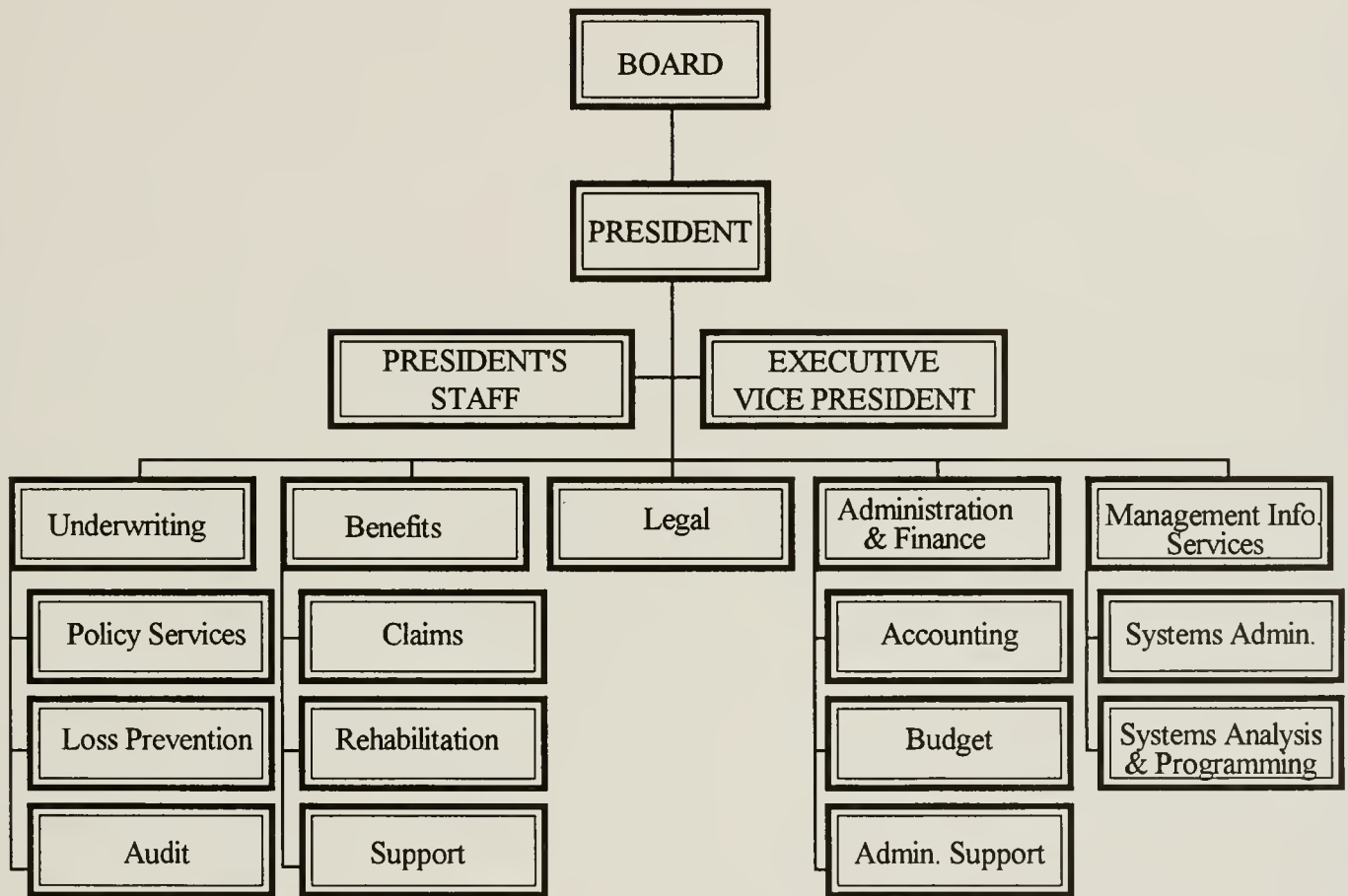
Sincerely,

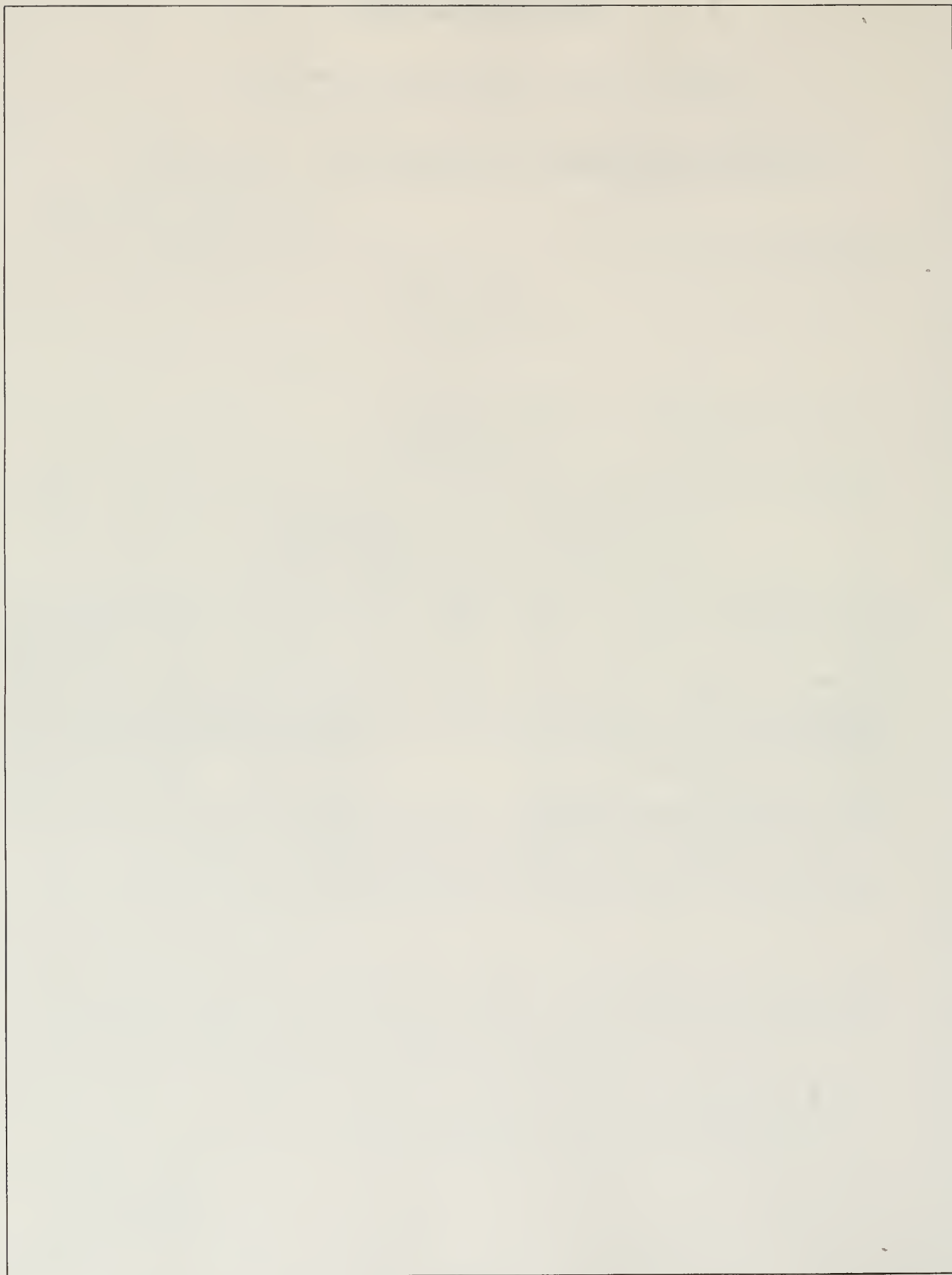


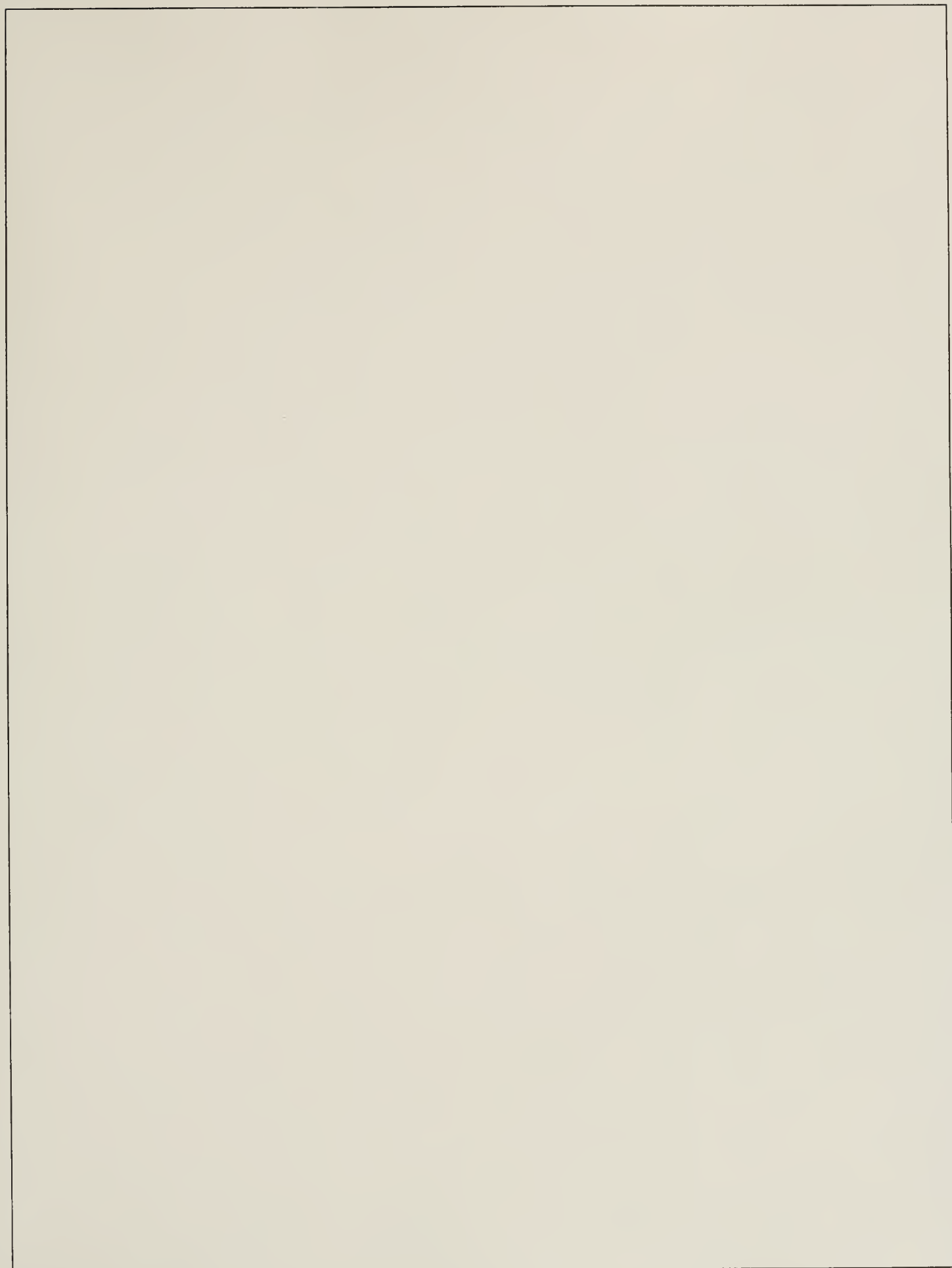
Martin A. Lewis, FCAS, MAAA

MAL:elb

ORGANIZATIONAL CHART







STATE COMPENSATION MUTUAL INSURANCE FUND
5 South Last Chance Gulch
Helena, Montana 59601

